

Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

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In the Matter of )

Price Cap Performance Review )

for Local Exchange Carriers; )

Treatment of Video Dialtone Services )

Under Price Cap Regulation )

CC Docket No. 94-1

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**REPLY COMMENTS OF COX ENTERPRISES, INC.**

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May 17, 1995

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**REPLY COMMENTS OF COX ENTERPRISES, INC.**

Cox Enterprises, Inc. ("Cox"), by its attorneys hereby files its reply comments in response to the Commission's Further Notice of Proposed Rulemaking in the above-captioned proceeding to determine whether to create a separate price cap basket for video dialtone services.<sup>1/</sup>

**I. INTRODUCTION AND SUMMARY**

The main issues before the Commission are (i) whether to establish a price cap basket for LEC video offerings to deter anticompetitive abuses and (ii) if so, how best to design a basket to advance this goal, in particular, and the Commission's other public interest

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<sup>1/</sup> *Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation*, CC Docket No. 94-1 (released February 15, 1995) (the "Notice").

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goals in general. First, Cox has shown in its comments<sup>2/</sup> that price cap regulation should not be applied to LEC video offerings because LEC video programming provided in conjunction with video transport is a cable service subject to Title VI. Treating a LEC offering video services as a cable operator providing cable service under Title VI will begin the process of introducing parity among LECs and similarly situated cable operators.

LEC video offerings should not be "streamlined" by "removal" from price caps, as some LECs recommend. Deregulating LEC video offerings would only give a LEC an incentive improperly to shift the huge costs of rebuilding its network optimized for video onto captive telephony ratepayers. Price cap regulation cannot meet this anticompetitive threat.

If the Commission can articulate a legal basis for placing LEC video offerings under price caps, the Commission should create an entirely separate price cap basket and rules to protect monopoly ratepayers from cross-subsidies in LEC video offerings. These rules should allocate direct and common costs associated with LEC video offerings in a rational and equitable manner. A separate Part 69 access charge category should be established for LEC video rates to prevent costs and revenues associated with LEC video rate elements from contaminating telephony services in other baskets. A separate productivity factor for the basket must be set at zero. Video revenues should not be factored into a LEC's interstate rate of return for sharing or low end adjustment purposes.

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<sup>2/</sup> See Comments of Cox Enterprises, Inc., at 4-5 (filed April 17, 1995) (hereinafter "Cox Comments").

## **II. THE POTENTIAL FOR ANTICOMPETITIVE ABUSES IN LEC VIDEO OFFERINGS REQUIRES A LEVEL OF SCRUTINY GREATER THAN THAT APPLIED UNDER PRICE CAP REGULATION**

Without addressing the appropriate legal framework for LEC video programming operations, most LECs propose "streamlined"<sup>3/</sup> deregulation of their video offerings.<sup>4/</sup> Deregulation of LEC video offerings, however, would unjustly enrich LECs by allowing them to engage in anticompetitive practices without detection. The potential for anticompetitive abuses in LEC video offerings requires a level of regulatory scrutiny *greater* than price caps, not "streamlining."

Generally, the Commission's "streamlining" policy derives from its intention that price cap regulation serve as only one phase in a transition from rate regulation of local and long distance telecommunications ultimately to full competition.<sup>5/</sup> To "streamline" a service by removal from price caps, the Commission must find that the carrier faces

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<sup>3/</sup> "Streamlining" means that a service is removed from price cap regulation (but remains a tariffed Title II offering) upon a finding that the service is subject to competition. *See Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, CC Docket No. 94-1, at ¶ 406 (released April 7, 1995) (*LEC Price Cap Performance Review Order*).

<sup>4/</sup> *See* Bell Atlantic Comments, at 1-3; GTE Comments, at 1-11; NYNEX Comments, at 2-4; PacTel Comments, at 2-5; Rochester Comments, at 2-5; USTA Comments, at 1-3; U S West Comments, at 3-12.

<sup>5/</sup> *See Price Cap Performance Review for Local Exchange Carriers*, Notice of Proposed Rulemaking, 9 FCC Rcd at 1687, 1701-05 (1994). The price cap performance review proceedings, thus, periodically monitor the functioning of price caps to effectuate this transition. *See id.*

competition and that the benefits of subjecting the service to free-market forces outweigh the costs of regulation.<sup>6/</sup>

As Cox demonstrated in its Comments, a LEC that provides video programming directly to end users on its own video network is a cable operator providing cable service under Title VI.<sup>7/</sup> Without Title VI regulation and increased regulatory scrutiny, however, the potential for cross-subsidy in LEC video offerings is magnified. As some commenters assert, price caps alone cannot and will not address the anticompetitive problems presented by integrated provision of LEC video offerings and monopoly telephone services, "until the Commission explicitly decides how much of the cost of [LEC video offerings] *should* be borne by telephone ratepayers . . . ."<sup>8/</sup>

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6/ For example, the Commission has found that AT&T's commercial long distance service should be streamlined because it would "result in a substantially more dynamic and proactive market without presenting an undue risk of undetected and unremitted anticompetitive action." *See Revisions to Price Cap Rules for AT&T Corp.*, Report and Order, CC Docket No. 93-197, 76 Rad. Reg. 2d (P&F) 1375, 1379-81 (1995) (the Commission "streamlined" AT&T's commercial long distance services by removal from the business services basket) (*AT&T Commercial Services Order*) (citing *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd 5880, 5895 (1991)).

7/ A cable operator is a person that provides "cable service" over a "cable system." 47 U.S.C. § 522(5)-(6). "Cable service" is "the one-way transmission to subscribers of (i) video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection of such video programming, or other programming service." *Id.* Telephone companies undoubtedly intend to transmit "video programming" to subscribers, and as such, are providing cable service and are cable operators. *See* Comments of Cox, at 4-5.

8/ *See* Comments of National Cable Television Association (NCTA), at 4 (NCTA Comments) (emphasis in original); Comments of California Cable Television Association (CCTA), at 12-14 (CCTA Comments).

The LECs contend that as "new entrants" in video markets they lack market power and that video markets are sufficiently competitive to warrant "streamlined" non-price cap treatment.<sup>9/</sup> Unlike other services that have received "streamlined" treatment,<sup>10/</sup> however, LEC video offerings have not been subject to an extensive period of rate regulation upon which the Commission could base a finding that "streamlining" is warranted. Nor do the "benefits" of allowing LECs to offer video services on a virtually deregulated basis outweigh the costs of applying regulations sufficient to reflect the strong likelihood that LECs will engage in anticompetitive cross-subsidization and predation in their video offerings. By shifting the focus to their supposed competitive status<sup>11/</sup> in video markets, LECs cloud the central issue -- whether additional regulation of LEC video offerings is necessary to prevent LECs from improperly shifting the costs of video offerings onto captive monopoly ratepayers.

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<sup>9/</sup> LECs claim that "regulatory parity" requires exempting their video offerings from price cap regulation because cable operators are exempt from rate regulation if the Commission finds that they face "effective competition." See 47 U.S.C. §§ 523(a)(2), (l). These LECs overlook the critical fact that cable operators are currently subject to price caps, regardless whether such regulation is lifted when the necessary competitive findings are met.

<sup>10/</sup> Although some of AT&T's services have been streamlined by removal by price caps, no LEC services have received streamlined treatment. See note 11 *infra*.

<sup>11/</sup> Some LECs argue that their video offerings be "removed" from price caps because they are subject to "competition." See, e.g., Bell Atlantic Comments, at 2-5; GTE Comments, at 4-7; NYNEX Comments, at 2-4; PacTel Comments, at 2-5. This is pure conjecture. The Commission removes a service from price caps only after making specific findings based on a time- and labor-intensive historical market study of competition, relative market share, and supply and demand elasticities. See *AT&T Commercial Services Order*, 76 Rad. Reg. 2d (P&F) at 1379-81. More importantly, no LEC price cap services have been found to face sufficient competition to merit streamlining. See *LEC Price Cap Performance Review Order*, at ¶¶ 406-08 (the Commission found that the record did not support a finding that sufficient competition existed to streamline LEC services).

LEC incentives to cross-subsidize their video offerings with increases in their monopoly ratebase would only multiply if regulation of LEC video ventures were "streamlined."<sup>12/</sup>

**III. EVEN IF THE COMMISSION CAN PROVIDE A LEGAL BASIS FOR REGULATING LEC VIDEO OFFERINGS UNDER PRICE CAPS, A SEPARATE BASKET ALONE WILL NOT ENSURE THAT LECS SATISFY THEIR DUTY TO ALLOCATE VIDEO-RELATED COSTS IN A JUST AND REASONABLE MANNER.**

Even if the Commission can provide an appropriate legal basis for regulating LEC video offerings under price caps, creation of a separate basket alone will not address the significant potential for LECs to engage in cross-subsidization of their video ventures. Any separate basket the Commission establishes for LEC video offerings must be accompanied by additional cost allocation requirements pursuant to Part 64 cost-accounting methods and strict rules to protect against cost-shifting and other abuses. If LEC video offerings are placed under price caps, moreover, the Commission must remain continually mindful of the anticompetitive threat that will persist in LEC video offerings, absent heightened and constant regulatory scrutiny appropriately targeted to the substantial capital investment LECs must make to rebuild their entire network optimized for video and the serious risk that monopoly ratepayers will be unfairly forced to fund such investment activity through LEC misallocations of video-related costs.

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<sup>12/</sup> In a recently filed amendment to its cost support materials for its video dialtone tariff in Dover, New Jersey, Bell Atlantic improperly redacted key cost information from the amendment, claiming it was proprietary, without prior Commission authorization. Such thinly-veiled attempts to cut off meaningful public debate only reinforces the perception that the LECs intend to game the Commission's regulatory system and the likelihood that their instant request for "streamlining" constitutes another chapter in this history. *See Bell Atlantic Transmittal No. 741 - Amended (filed May 5, 1995) (Bell Atlantic Cost Amendment).*



**A. If LEC Video Offerings Are Regulated Under Price Caps, a Separate Basket Is Necessary.**

As Cox demonstrated in its Comments and almost unanimously supported by other commenters, video services are unlike any existing LEC service under price caps and should be placed in a separate basket, if LEC video offerings are placed under price cap regulation, to inhibit the ability of LECs to engage in cross-subsidization.<sup>13/</sup>

Placing LEC video offerings under price cap regulation in an existing basket would fail to achieve, and in fact hinder, the Commission's goals. To foster a competitive video marketplace, the Commission must ensure a level playing field for LEC video offerings and cable operators. Absent a separate basket for LEC video offerings, as MCI indicates in its comments, LECs could "utilize existing price cap baskets and pricing flexibility rules to game the system and achieve predatorily low rates . . . , while placing the burden for such low prices on existing telephony and access ratepayers."<sup>14/</sup> Under a price cap system of regulation, a separate price cap basket for LEC video offerings is thus required.

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<sup>13/</sup> See Cox Comments, at 9-16; Comments of Ad Hoc Telecommunications User Committee (Ad Hoc), at 5-9 (Ad Hoc Comments); Comments of AT&T, at 3-5 (AT&T Comments); CCTA Comments, at 5-7; Comments of MCI Telecommunications Corp., at 2-7 (MCI Comments); NCTA Comments, at 6-8; Comments of United and Central Telephone Cos., at 1-2 (United-Central Comments).

<sup>14/</sup> See MCI Comments, at 3-5.

**B. The Commission Must Apply Cost Allocation Principles To LEC Video Ventures That Recognize the Serious Anticompetitive Threats Such Offerings Raise.**

As Cox stated in its Comments, application of Part 64 cost accounting methods are necessary.<sup>15/</sup> The large costs that LECs must invest to reconstruct an entire network optimized for video delivery must be reflected in LEC video rates. To mitigate the potential for LECs to shift the costs of video network rebuilds onto telephony ratepayers, the Commission should require LECs to separate costs associated with their regulated telephony services from their video offerings, which are nonregulated Title VI cable services. Such treatment is consistent with, and in fact, required by the *Joint Cost Order*.<sup>16/</sup>

Part 64 would require LECs to make proper cost identification and separation by requiring them to file and maintain individualized cost allocation manuals ("CAMs") and to conduct annual audits to demonstrate compliance with their CAMs and Commission rules.<sup>17/</sup> Application of Part 64 cost-allocation and accounting would greatly assist in

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<sup>15/</sup> *Separations of Costs of Regulated Telephone Service From Costs of Nonregulated Activities*, Report and Order, 2 FCC Rcd 1298 ("Joint Cost Order"), *aff'd*, *Southwestern Bell Tel. Co. v. F.C.C.*, 896 F.2d 1378 (D.C. Cir. 1990). Part 64 is designed to identify costs associated with nonregulated services and to protect customers of regulated services from bearing costs associated with non-regulated services. See 47 C.F.R. §§ 64.901 *et seq.*

<sup>16/</sup> Such treatment also has the virtue of consistency with the accounting treatment required of cable operators. Under the Commission's interim cost of service rules, cable operators are required to separate non-cable costs and revenues pursuant to Part 64 principles. 47 C.F.R. § 76.924(e)-(f). Because cable operators are required to separate costs and revenues associated with regulated telephone services from costs and revenues of regulated cable services, it would be both unfair and illogical not to require telephone companies to comply with the same cost allocation principles when they provide non-regulated services.

<sup>17/</sup> *Id.*

ensuring a fair and equitable cost allocation among all ratepayers by separating the costs associated with LEC video services on the transport network as a non-regulated service from the costs of regulated telephony service.<sup>18/</sup> Moreover, treatment of all facilities operated by a LEC video programmer as cable facilities comports with the way the Commission has treated LEC ventures into the cable market in the past.<sup>19/</sup>

LEC proposals to modify the existing price cap new services test to *increase* their pricing flexibility would allow them to avoid cost-justifying their video offerings on any rational and even-handed basis.<sup>20/</sup> Currently, the new services test requires a LEC to report base period demand from the time a new service tariff is filed until the service is rolled into the price cap in the subsequent annual access filing. Because the annual access filing occurs in April of each year, the time covered by base period demand will vary depending on when the LEC filed its tariff.<sup>21/</sup> LEC proposals to modify the historical base period, which range

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18/ The Commission's rules already require that LEC "basic" video dialtone platform costs be separated from LEC "enhanced" video services using Part 64. This separation alone, however, is insufficient to guard against massive cost misallocations.

19/ See *General Telephone Company of California*, Memorandum Opinion and Order, Order on Authorization, 4 FCC Rcd 5693 (1989) (requiring GTE to treat all costs associated with video facilities as unregulated activity costs in keeping with accounting rules adopted in the *Joint Cost Order*).

20/ GTE proposes immediate price cap credit for new video service rates. GTE Comments, at 17-18. Cf. U S West Comments, at 17-18 (proposes a full calendar year of base period demand); PacTel Comments, at 5 (seeks three to five years of base period demand).

21/ The base period is "necessary to develop historical demand data that the actual price index and service band index require." See *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786, 6825 n.415 (1990) (*LEC Price Cap Order*).

from elimination of any base period to expansion of a base period from one to five calendar years, would enable LECs to evade meaningful periodic review and thereby engage in anticompetitive activities.<sup>22/</sup>

**C. As MCI Correctly Indicates, Creation of a Separate Part 69 "Bucket" Would Be Necessary If the Commission Establishes a Separate Price Cap Basket for LEC Video Offerings.**

Creation of a separate Part 69 access category "bucket" for LEC video offerings would be necessary, if the Commission establishes a separate price cap basket for LEC video offerings, to separate LEC video rates properly prior to inclusion in price caps. Currently, Part 69 rules require LECs to separate their interstate access charges into four categories; (i) traffic sensitive; (ii) common line; (iii) interexchange; and (iv) special access.<sup>23/</sup> This separations process rationalizes LEC access rates for the purposes of placing these rates in the common line, traffic sensitive, trunking and interexchange price cap baskets. Application of a

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<sup>22/</sup> The *Bell Atlantic Cost Amendment*, for example, and the cost-showing in Bell Atlantic's initial filing are defective in many respects. One of the most egregious defects is Bell Atlantic's failure to provide any demand elasticity information, in spite of the Commission's policy that it would "scrutinize the basis for claims and projections of demand elasticities," and that interested parties would be provided "ample opportunity to comment on these claims and projections." See *Letter Comments Regarding Bell Atlantic Tariff F.C.C. No. 10, Transmittal No. 741*, from Counsel for Adelphia Communications Corp., Comcast Cable Communications, Inc., Cox Enterprises, Inc., Jones Intercable, Inc., to Geraldine Matise, Chief, Tariff Division, Common Carrier Bureau, Federal Communications Commission, (May 15, 1995) at 3 (citing *Telephone Company-Cable Television Cross Ownership Rules*, Memorandum Opinion and Order and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244, 346 (1994)). The *Bell Atlantic Cost Amendment* is yet another instance of the LECs' willingness to game the system to avoid substantive review of their video-related costs.

<sup>23/</sup> See 47 C.F.R. §§ 69.1 *et seq.*

separate Part 69 "bucket" to LEC video rates would properly secure the integrity of the access charge separations process and the index associated with the separate LEC video price cap basket.

If LEC video investments were allowed to "flow" into existing Part 69 access categories, as MCI correctly indicates, they would be reflected in the interstate rate of return used to calculate sharing and low-end adjustments, thereby giving LECs an additional opportunity to cross-subsidize video investments through telephony ratepayers.<sup>24/</sup> Creation of a separate access category for LEC video offerings would require LECs to maintain totally separate accounts for video revenues, expenses, and investments.<sup>25/</sup>

**D. Most Commenters Support a Zero Productivity Factor.**

The Commission included a productivity factor in the LECs' price cap index (PCI) formula to ensure that rates would steadily decline in relation to a measure of inflation factored into the PCI by the Gross National Product-Productivity Index (GNP-PI) variable.<sup>26/</sup> As demonstrated in Cox's comments, the Commission lacks sufficient information regarding

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<sup>24/</sup> See MCI Comments, at 13-15.

<sup>25/</sup> See *id.* In contrast, GTE's proposal to eliminate Part 69 and waiver requirements with respect to LEC video offerings only reinforces the concern that LECs intend to exploit captive ratepayers to cross-subsidize their video investments. See GTE Comments, at 16-17.

<sup>26/</sup> The Commission initially set the productivity factor based on two Commission staff studies of the extent to which LEC productivity historically outperformed the economy as a whole. See *LEC Performance Review Order*, at ¶ 201. The Commission recently set interim productivity factors and initiated a proceeding to determine whether a higher productivity factor is necessary. See *id.*

LEC video ventures to set any productivity factor.<sup>27/</sup> The majority of commenters, including most LECs, support setting the productivity factor at zero.<sup>28/</sup>

In addition to a lack of information regarding LEC video ventures, there is a strong likelihood that LECs will underearn in their video offerings, in light of the huge capital investment necessary to rebuild entirely new networks optimized for video services. Insufficient experience with LEC video offerings and the likelihood that LECs will underearn necessitate a zero productivity factor for a separate price cap basket established for LEC video offerings.

**E. There Should Be No Unified Sharing Across Baskets.**

As Cox demonstrated in its comments and as widely supported by other commenters, any sharing and low end adjustments for a separate price cap basket for LEC video offerings should not be applied across baskets.<sup>29/</sup> Under current rules, a LEC is required to "share" any overearnings above a targeted rate of return with ratepayers by means of implementing a sharing adjustment.<sup>30/</sup> The Commission should implement separate

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<sup>27/</sup> See Cox Comments, at 21-25.

<sup>28/</sup> See Ad Hoc Comments, at 11-16; BellSouth Comments, at 10-11; CCTA Comments, at 10-12; GTE Comments, at 19-20; MCI Comments, at 9-11; NCTA Comments, at 9-11; NYNEX Comments, at 6-7; PacTel Comments, at 7-8; Rochester Comments, at 7-9; Southwestern Bell Comments, at 4-6; USTA Comments, at 4; U S West Comments, at 13-14.

<sup>29/</sup> See Cox Comments, at 25-27. See also Ad Hoc Comments, at 19-20; AT&T Comments, at 5-6; Comments of General Services Administration (GSA), at 6-7; MCI Comments, at 12-13; NYNEX Comments, at 9-10; United-Central Comments, at 3; U S West Comments, at 14-15.

<sup>30/</sup> See LEC Price Cap Performance Review Order, at ¶¶ 167-71.

sharing and low end adjustment mechanisms to the separate price cap basket for LEC video offerings to prevent LECs from exploiting opportunities to cross-subsidize that would otherwise arise under unitary sharing and low end mechanisms.

Under current price cap rules, LECs are required to implement sharing obligations based on their total interstate rate of return from all basket revenues and to allocate the sharing obligation among baskets on a cost-causative basis.<sup>31/</sup> If revenues from a separate basket for LEC video offerings were included in calculating a LEC's total interstate rate of return, a LEC would have a strong incentive improperly to withhold sharing allocations from captive telephony ratepayers and use the overearnings to fund video programming investment. To allow LECs to use earnings in the video-only price cap basket in calculating their interstate rate of return would give them opportunity to engage in improper cost-shifting by using apparent depressed earnings in the video-only basket to gain comparable increases in low-end rates in noncompetitive telephony baskets. If a video-only basket is established, therefore, unified sharing should not apply to it.

#### IV. CONCLUSION

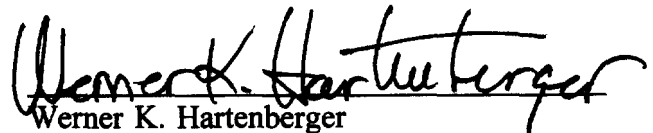
For the foregoing reasons, the Commission should regulate LEC video programming as what it truly is -- cable service over a cable system subject to Title VI. If the Commission can identify an appropriate regulatory theory to permit the establishment of a separate price cap basket for LEC video offerings, it must plainly identify what types of

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<sup>31/</sup> See *1992 Annual Access Tariff Filings*, CC Docket No. 92-141, 7 FCC Rcd 4731, 4732-33 (Com. Car. Bur. 1992).

investments belong in that basket and ensure that any price cap basket established for LEC video offerings meets the following criteria: (i) a Part 64 cost allocation methodology must be employed between LEC video networks and LEC telephony investments; (ii) a separate Part 69 access charge category for LEC video rates should be established; (iii) the productivity factor associated with such a basket must be set at zero; and (iv) there should be no unified sharing across the video basket to any other baskets. These additional protections are essential to introduce a degree of regulatory parity among similarly situated LECs offering video services and cable operators and to protect LEC telephony ratepayers from massive cross-subsidies.

Respectfully submitted,  
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May 17, 1995



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I, Tracie Ivey, do hereby certify that on this 17th day of May, 1995, copies of the foregoing "Reply Comments of Cox Enterprises, Inc.," were delivered by hand, unless otherwise indicated, to the following parties:

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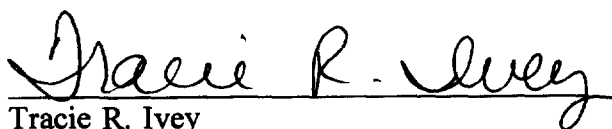
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